

**LEGISLATIVE SERVICES AGENCY
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FISCAL IMPACT STATEMENT

LS 7574

BILL NUMBER: HB 1712

NOTE PREPARED: Jan 29, 2005

BILL AMENDED:

SUBJECT: Veterans Benefits.

FIRST AUTHOR: Rep. Reske

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides a deduction in computing the Adjusted Gross Income of an individual or an individual's surviving spouse for all income received during the taxable year as compensation, retirement benefits, or survivor's benefits for the individual's service in an active or reserve component of the Armed Services of the United States. The bill also provides for a payment of \$500 to each member of the National Guard or of any reserve component of the National Guard or the Armed Forces who is placed on involuntary activation for 150 days or more and served outside the state after September 10, 2001. The bill appropriates money to the Department of Veterans' Affairs for the payments.

Effective Date: July 1, 2005; January 1, 2006.

Explanation of State Expenditures: *Involuntary Activation Payment:* The involuntary activation expense payment established by the bill could potentially cost \$4.6 M in FY 2006 and \$1.5 M FY 2007. This estimate is based on counts of Indiana National Guard personnel (both Army and Air Force) deployed since 2001. It also assumes the number of National Guard personnel from Indiana deployed in the future averages about 3,000 per year. In addition, the fiscal impact could be higher to the extent that reservists of the U. S. Armed Forces who are residents of Indiana also qualify for this payment. Information on this group is currently unavailable. Once this information is obtained from the Defense Manpower Data Center, the fiscal impact will be updated.

Background: The bill entitles a person who is a member of the Indiana National Guard or of any reserve component of the Indiana National Guard or the Armed Forces to receive a \$500 expense payment from the Indiana Department of Veterans' Affairs if the person: (1) is a resident of Indiana; (2) is placed on involuntary

activation after September 10, 2001; and (3) serves for 150 days during a 365 day period outside Indiana. The expense payment would be effective beginning in FY 2006. The bill annually appropriates a sufficient amount from the state General Fund to the Department to make the required expense payments. According the Adjutant General's Office 5,994 Indiana National Guard personnel have been deployed and come home since the end of 2001. In addition, 3,264 personnel are currently deployed.

Department of State Revenue (DOR): The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to incorporate the change to the military income deduction. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Summary:* The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities of individual taxpayers who are active duty or reserve military personnel or who receive military retirement benefits. The revenue loss due to this bill could potentially total \$18.6 M in FY 2007. The revenue loss could potentially increase thereafter by about 1.6% annually. (Note: This deduction also would apply to the involuntary activation expense payment provided for under the bill (see above under *Explanation of State Expenditures*).)

Background: The bill eliminates the existing AGI Tax deduction for the first \$2,000 in military service income (including military retirement and survivor's benefits) received during a taxable year and, instead, provides a full deduction from AGI for military service income. Since the bill is effective beginning in tax year 2006, the fiscal impact would begin in FY 2007. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

Under current statute, a taxpayer may deduct up to \$2,000 in military service income. State tax data indicates that 36,513 taxpayers claimed the deduction for military service pay and retirement benefits in tax year 2002, deducting approximately \$72.2 M in military pay and retirement benefits. This amount resulted in a revenue loss of about \$2.4 M. Based on U. S. Department of Defense military census and pay rate data, it is estimated that military retirement income in excess of the deductible amounts could potentially total about \$548.0 M in 2006. If this amount is also deducted from AGI, the revenue loss would total about \$18.6 M in FY 2007. The revenue loss could be somewhat lower to the extent that retirement income is already tax exempt (i.e., disability retirement income). Recent DOD retirement pay data does not delineate between taxable and tax exempt military retirement payments to Indiana retirees. However, the proportion that is tax exempt is not expected to exceed 10% of total retirement payments.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the proposed deduction for civil service and military pension benefits would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) could potentially experience a significant decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue; Department of Veterans' Affairs.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: Deborah Williamson, Defense Manpower Data Center, 831-583-2400. Lt. Col. Larry Powers, Adjutant General's Office, (317) 247-3222.

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